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Coining New Tax Guidance: How the IRS is Falling Behind in Crypto

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COINING NEW TAX GUIDANCE: HOW THE IRS IS FALLING BEHIND IN CRYPTO

By David C. McDonald[*]

ABSTRACT

In October 2019, the Internal Revenue Service offered its first guidance on cryptocurrency reporting standards in nearly five years. As digital investments become more commonly accepted, the need for regulation and guidance becomes clearer. Issues such as how to classify cryptocurrencies and how a transaction's purpose impacts reporting standards are currently being addressed across the globe as governments work to develop protocols that organize this rapidly developing field. This note analyzes the developing reporting standards of select countries and the potential impacts on use as cryptocurrencies become more mainstream as a potential investment and method of payment.

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I. Introduction

In October 2019, the IRS offered its first guidance on cryptocurrency reporting standards in nearly five years.[1] The 2019 guidance, composed of Revenue Ruling 2019-24[2] ("R.R. 2019-24") and a frequently asked questions ("FAQ") section,[3] is designed to help taxpayers better understand their tax obligations for specific transactions involving virtual currency.[4] R.R. 2019-24 focuses on reporting requirements of hard forks[5] and the FAQ section is designed to address transactions for those who hold cryptocurrencies as a capital asset.[6] Altogether, the 2019 guidance clarifies treatment of hard forks and illustrates how existing tax principles will apply to cryptocurrencies. The guidance comes as a relief, especially in a fast-paced sector like technology where five years can seem like an eternity.[7]

While still largely misunderstood, the potential disruption to the financial sector by cryptocurrencies and the underlying blockchain technology is well-recognized.[8] Several issues remain unanswered but the new guidance provides clarity into how the IRS is evaluating the

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[1] *See* Stephen L. Ham IV & Ivan Taback, *IRS Issues First Guidance on Cryptocurrency Since 2014*, WEALTH MANAGEMENT (Oct 16, 2019), https://www.wealthmanagement.com/high-net-worth/irs-issues-first-guidance-cryptocurrency-2014.

[2] Rev. Rul. 2019-24, 2019-44 I.R.B. 1004 [hereinafter R.R. 2019].

[3] Internal Revenue Serv., *Frequently Asked Questions on Virtual Currency Transactions* (2019), https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions [hereinafter FAQ].

[4] I.R.S. News Release IR-2019-167 (Oct. 9, 2019) [hereinafter Press Release].

[5] *Infra* section V.

[6] *Id.*

[7] Kevin Helms, *IRS Issues New Crypto Tax Guidance - Experts Weigh In*, BITCOIN.COM (Oct. 10, 2019), https://news.bitcoin.com/irs-issues-new-crypto-tax-guidance-after-5-years-experts-weigh-in/ [hereinafter Helms, *Experts*].

[8] *See* Elizabeth Sarah Ross, *Nobody Puts Blockchain in a Corner: The Disruptive Role of Blockchain Technology in the Financial Services Industry and Current Regulatory Issues*, 25 CATH. U. J. L. & TECH. 353 (2017).

tax consequences of cryptocurrencies.[9] The 2019 guidance builds off of Revenue Ruling 2014-21 which "applied general principles of tax law to determine that virtual currency is property for federal tax purposes"[10] and continues to develop and apply those same longstanding tax principles to additional crypto situations.[11] Simply put, traditional capital gains rules will, for the most part, continue to apply to cryptocurrency gains and losses.[12]

The issue, however, is that while this new guidance provides slightly more insight into how the IRS views gains and losses made through crypto, there are still deeper issues tied into the complexities of cryptocurrencies and their inability to conform to an existing framework. As the 2014 guidance notes, the IRS allows for some flexibility by dividing cryptocurrencies into capital and non-capital assets, depending on how they are utilized by a taxpayer.[13] However, this is only the tip of the iceberg. Due to the high customizability of digital currencies, new cryptocurrencies can be developed for several purposes.[14] For example, some common utilizations of crypto include transactional currencies, blockchain currencies, and collateralized "stablecoins," which are backed by real currency, digital currency, or real property.[15] Each of these categories have different intended uses and thus potentially deserve different treatments by tax agencies like the IRS.[16]

With this degree of variation, it is difficult to regulate cryptocurrency effectively.[17] Current regulatory schemes are not

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[9] Stephen L. Ham IV & Ivan Taback, *IRS Issues First Guidance on Cryptocurrency Since 2014*, WEALTH MGMT. (Oct 16, 2019), https://www.wealthmanagement.com/high-net-worth/irs-issues-first-guidance-cryptocurrency-2014.

[10] Press Release, *supra* note 4.

[11] FAQ, *supra* note 3.

[12] Kelly Phillips Erb, *What You Need To Know About Taxes & Cryptocurrency*, FORBES (Jan. 9, 2018), https://www.forbes.com/sites/kellyphillipserb/2018/01/09/what-you-need-to-know-about-taxes-cryptocurrency/#616ff4a7605f.

[13] *See* Rev. Rul. 2014-21, 2014-16 I.R.B. 938 [hereinafter R.R. 2014].

[14] *What are the different types of cryptocurrencies?*, AAX ACADEMY (2019), https://academy.aax.com/en/different-types-of-cryptocurrencies/.

[15] *Id.*

[16] *Id.*

[17] Ryan Clements, *Assessing the Evolution of Cryptocurrency: Demand Factors, Latent Value, and Regulatory Developments*, 8 MICH. BUS. & ENTREPRENEURIAL L. REV. 73, 81 (2018).

designed for this degree of variation, and regulators have difficulty keeping up with the breakneck speed of innovation in the sector.[18] Creating comprehensive regulation for cryptocurrency is therefore difficult, if not impossible, under current regulatory standards. However, regulators naturally want to avoid the "cobra effect" where an innovative solution to a problem only makes matters worse.[19] And so, R.R. 2019-24 and the 2019 guidance as a whole forges forward in an attempt to apply existing frameworks to cryptocurrencies, particularly the phenomenon known as a "hard fork."[20] While Section V of this paper covers what a hard fork is in greater detail, a basic definition of a hard fork is the process where a cryptocurrency is split into two fully-functional currencies, both sharing the same transaction history but one maintains the original validation rules and one has updated validation rules that change how the blockchain is validated after the split.

In an effort to understand the implications of the IRS's new guidance and the difficulty in adapting traditional tax principles to cryptocurrencies, it is important to understand the nuances of hard forks and the wide degree of applicability. This paper analyzes how shortcomings in the IRS's proposed model on hard forks can be addressed by looking internationally at the benefits of other systems.

II. CURRENT VIEWS ON CRYPTOCURRENCY

As with most things new and foreign, cryptocurrency was initially viewed distrustfully by many governmental bodies.[21] Bitcoin,

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[18] *Id.* (*citing Edward v. Murphey, et al.*, Cong. Research Serv., R43339, Bitcoin: Questions, Answers, and Analysis of Legal Issues, Congressional Research Services (2015); Marcel T. Rosner & Andrew Kang, Note, *Understanding and Regulating Twenty-First Century Payments Systems: The Ripple Case Study*, 114 MICH. L. REV. 649 (2016); Bank for Int'l Settlements, Basel Committee on Banking Supervision, Implications of Fintec Developments for Banks and Bank Supervisors—Consultative Document (Aug. 2017), http://www.bis.org/bcbs/publ/d4l5.htm).

[19] *Id*.

[20] Press Release, *supra* note 4.

[21] Jason Bloomberg, *Using Bitcoin Or Other Cryptocurrency To Commit Crimes? Law Enforcement Is Onto You*, FORBES (Dec. 28, 2017), https://www.forbes.com/sites/jasonbloomberg/2017/12/28/using-bitcoin-or-other-cryptocurrency-to-commit-crimes-law-enforcement-is-onto-you/#739536273bdc ("[G]lobal law enforcement recognizes that cryptocurrency is the criminal's playground.").

being the only cryptocurrency for a number of years,[22] was viewed as, and indeed used as,[23] a way to foster cyber-crime and money laundering due to its lack of oversight and the protection of users' anonymity through its blockchain structure.[24] However, since then, some governments have become much more open to adopting blockchain for more civilized application.[25] Attitudes toward virtual currencies have since taken various forms depending on the jurisdiction, including "indifference, permissiveness, and hostility"[26] or even creating a state-backed cryptocurrency to mirror real currency.[27]

Corporations switched their stance on crypto as well once the value of an Initial Coin Offering, or "ICO,"[28] became clear.[29] In 2018, tech giants such as Google, Facebook, and Twitter implemented bans against virtual currency advertisements on their platforms because of "vulnerability concerns."[30] However, in early 2019, BitTorrent, a software company specializing in decentralized file-sharing, raised over seven million dollars in less than fifteen minutes through an ICO.[31] By June 2019, Facebook realized there was money to be made

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[22] Andrew Norry, *The Complete History of Cryptocurrency for Beginners*, PARAMETER (Nov. 5, 2018), https://parameter.io/history-of-cryptocurrency/.

[23] Matt Schiavenza, *Without Drugs, What's the Point of Bitcoin?*, THE ATLANTIC (Jan. 17, 2015), https://www.theatlantic.com/technology/archive/2015/01/without-drugs-whats-the-point-of-bitcoin/384622/ (discussing the trial of Ross Ulbricht, the founder of Silk Road, an online market that allowed users to buy and sell illegal drugs using bitcoins as currency); *see also* Bloomberg, *supra* note 21 (noting that cryptocurrencies like Bitcoin are "the criminal's playground," especially for crimes such as "tax evasion, money laundering, contraband transactions, and extortion").

[24] Bloomberg, *supra* note 21.

[25] Anisha Reddy, *Coinsensus: The Need for Uniform National Virtual Currency Regulations*, 123 DICKINSON L. REV. 251, 264-65 (2018) (internal citations omitted).

[26] *Id.*

[27] *See* Michael Del Castillo, *Alibaba, Tencent, Five Others To Receive First Chinese Government Cryptocurrency*, FORBES (Aug. 27, 2019); Daniel Palmer, *Russian Central Bank to Consider Gold-Backed Cryptocurrency*, COINDESK (May 23, 2019); Suparna Dutt D'Cunha, *Dubai Sets Its Sights On Becoming The World's First Blockchain-Powered Government*, FORBES (Dec. 18, 2017).

[28] Dr. Paul J. Ennis, James Waugh, & William Weaver, *Three Definitions of Tokenomics*, COINDESK (Mar. 17, 2018).

[29] Norry, *supra* note 22.

[30] Reddy, *supra* note 25, at 264.

[31] *Initial Coin Offerings – A Multi-Billion Industry (Hot ICO List 2019)*, TRADINGSTRATEGYGUIDES (last updated Dec. 3, 2019); Sam Ouimet, *Binance's*

and announced Libra, Facebook's cryptocurrency aimed at getting into the wallets of the 1.7 billion people globally who have smartphones but no access to traditional banking.[32] This trend toward acceptance and even enthusiasm demonstrates that cryptocurrencies are here to stay and that guidance must be developed for investors looking to safely explore this flourishing area.

III. THE NEED FOR A REGULATORY FRAMEWORK

As more users explore the potential applications of cryptocurrency and blockchain technology generally, it is increasingly clear that the user community needs protective regulation to monitor bad actors. Bearish analysts point to virtual currencies' beginning as a way to "procure illicit materials and fund human trafficking," due to the ease at which users can transmit funds without providing sensitive personal information.[33]

In fact, while regulators have been slow to act, ill-intentioned actors have not. Terrorist organizations, such as ISIS, have received funds through virtual currencies.[34] Hackers request Bitcoin as currency in exchange for information gleaned from ransomware attacks.[35] Investors who simply transact in cryptocurrencies are prone to thieves who can hack into virtual wallets.[36] Even virtual exchanges

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BitTorrent Token Sale Sells Out in Minutes Amid Technical Issues, COINDESK (Jan. 28, 2019).

[32] *See* Bill Chappell, *Facebook Unveils Libra Cryptocurrency, Sets Launch For 2020*, NPR (June 18, 2019), https://www.npr.org/2019/06/18/733701971/facebook-unveils-libra-cryptocurrency-sets-launch-for-2020; *see also* Julia Boorstin, *Facebook launches a new cryptocurrency called Libra*, CNBC (June 18, 2019), https://www.cnbc.com/2019/06/17/facebook-announces-libra-digital-currency-calibra-digital-wallet.html.

[33] Reddy, *supra* note 25, at 262-63.

[34] *Id.* at 263, (*citing* Zachary K. Goldman et al., *Terrorist Use of Virtual Currencies*, CNAS (May 3, 2017), http://bit.ly/2xFKlrc.); s*ee ISIS Fundraising in US via Bitcoin*, RT (Jan. 30, 2015), http://bit.ly/ 2xxsClq.

[35] *See* Joseph Cox, *Kidnappers Around the World Want Their Ransoms Paid in Bitcoin*, VICE (July 4, 2017), https://www.vice.com/en_us/article/zmvn44/kidnappers-around-the-world-want-their-ransoms-paid-in-bitcoin.

[36] *See* Alex Hern, *A History of Bitcoin Hacks*, GUARDIAN (Mar. 18, 2014), http://bit.ly/2PVJOy1; s*ee also* Laura Shin, *Hackers Have Stolen Millions of Dollars in Bitcoin Using Only Phone Numbers*, FORBES (Dec. 20, 2016), http://bit.ly/2tgc9ss.

are exposed to potential hacks.[37] Mt. Gox, the first and largest Bitcoin exchange, collapsed in 2014 after losing over $460 million in cryptocurrency to hackers.[38] Coincheck, a Japanese platform, lost $530 million to hackers in January 2018.[39] Bancor, an Israeli platform, lost $23 million in cryptocurrencies.[40]

However, law enforcement is cracking down.[41] The Silk Road, "a digital marketplace for illicit trade"[42] that was characterized as "one of [the] most nefarious possible applications of virtual currency"[43] was shut down in 2013 and its founder handed five prison sentences to be served concurrently, two of which are life sentences.[44] Regulators are attempting to bring order to some of the largest exchanges in the United States and Japan through government oversight.[45]

Despite the risks, cryptocurrencies continue to be a popular topic for the savvy investor.[46] "Concerns over virtual currency

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[37] *See* Rebecca M. Bratspies, *Cryptocurrency and the Myth of the Trustless Transaction*, 25 MICH. TECH. L. REV. 1, 40-42 (2018).

[38] Clements, *supra* note 17, at 92-93 (*citing* Robert McMillan, *The Inside Story of Mt. Gox, Bitcoin 's $460 Million Disaster*, WIRED (Mar. 3, 2014, 6:30 AM), https://www.wired.com/2014/03/bitcoin-exchange/).

[39] Bratspies, *supra* note 37, at 41(*citing* Daniel Shane, *$530 Million Cryptocurrency Hack May Be Largest Ever*, CNN BUS. (Jan. 29, 2018), https://money.cnn.com/2018/01/29/technology/coincheck-cryptocurrencyexchange-hack-japan/index.html).

[40] *Id.* at 40 (*citing* Jon Russell, *The Crypto World's Latest Hack Sees Bancor Lose $23.5M*, TECHCRUNCH, (July 11, 2018), https://techcrunch.com/2018/07/10/bancor-loses-23-5m/).

[41] Bloomberg, *supra* note 21 (noting that cryptocurrencies like Bitcoin are "the criminal's playground," especially for crimes such as "tax evasion, money laundering, contraband transactions, and extortion").

[42] Reddy, *supra* note 25, at 262 (citing Joshuah Bearman & Tomer Hanuka, The Rise and Fall of Silk Road, Pt. 1, WIRED, http://bit.ly/201K2Gz (last visited Jan. 3, 2020).

[43] *Id.*

[44] Sam Thielman, *Silk Road Operator Ross Ulbricht Sentenced to Life in Prison*, GUARDIAN (May 29, 2015), https://www.theguardian.com/technology/2015/may/29/silk-road-ross-ulbricht-sentenced.

[45] Nathaniel Popper, *Warning Signs About Another Giant Bitcoin Exchange*, N.Y. TIMES (Nov. 21, 2017), https://www.nytimes.com/2017/11/21/technology/bitcoin-bitfinex-tether.html.

[46] *See id.* (noting that thefts by hackers has not been enough to "stop customers from pumping billions of dollars worth of virtual currency trades" into crypto exchanges); *see also* Dan Saada, *Cryptocurrency Industry Progressing Despite Failings and Hacks*, CURRENCY ANALYTICS (Oct. 23, 2019) ("The industry is progressing despite its share of failings and hacks."); Nate Nead, *Cryptocurrency: Growth Trends &*

exchanges are nothing new,"[47] and those concerns are easily assuaged when investors and companies see a potential to make significant returns – remember how Facebook banned advertisements for cryptocurrencies because of security concerns and then developed Libra less than a year later? To further illustrate the point, consider the growth of Bitcoin over a five-year period. On December 31, 2014, one Bitcoin was worth roughly $320.19.[48] On December 31, 2019, one Bitcoin was worth roughly $7,193.60.[49] Similarly, trading volume for those two days increased from 13,942,900 in 2014[50] to 21,167,946,112 in 2019.[51] With this level of investment at play, regulators should be providing clear guidance that provides safeguards for investors without destroying the investment and innovation already poured into cryptocurrencies and blockchain as a whole. Governments are realizing regulatory action must be taken and disjointed efforts have sprung up throughout the international community.[52]

IV. A LOOK AROUND THE WORLD

Governments around the globe have recognized the need for regulation, and responses have varied as each tackles the rampant growth of crypto-finance's popularity in their own ways.[53] In the United States alone, multiple viewpoints have emerged as different federal agencies and states have created a "Franken-finance" because

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Industry Performance, Investment Bank (Feb. 28, 2018), https://investmentbank.com/crypto-growth/.

[47] Popper, *supra* note 45.

[48] Price of Bitcoin (BTC) at Close on Dec. 31, 2014, YAHOO FIN., https://finance.yahoo.com/quote/BTC-USD/history?period1=1419984000&period2=1419984000&interval=1d&filter=history&frequency=1d [hereinafter Bitcoin 2014].

[49] Price of Bitcoin (BTC) at Close on Dec. 31, 2019, YAHOO FIN., https://finance.yahoo.com/quote/BTC-USD/history?period1=1577750400&period2=1577750400&interval=1d&filter=history&frequency=1d [hereinafter Bitcoin 2019].

[50] Bitcoin 2014, *supra* note 48.

[51] Bitcoin 2019, *supra* note 49.

[52] *See* Joshua S. Morgan, *What I Learned Trading Cryptocurrencies While Studying the Law*, 25 U. MIAMI INT'L & COMP. L. REV. 159, 221-24 (2017).

[53] Mary Thibodeau, *Cryptocurrency Regulation Global Update 2020*, HEDGETRADE (Jan. 11, 2019), https://hedgetrade.com/cryptocurrency-regulation-global-update-2019/.

rulings are "full of absurd contradictions and incongruities."[54] Below are summaries of regulatory approaches to cryptocurrencies by various agencies within the United States and around the world.

A. Within the United States

Regulatory agencies' largest hurdle concerning cryptocurrencies is addressing the community in a uniform manner. Problematically, agencies like the IRS, SEC, and CFTC have each taken an incomplete approach to monitoring cryptocurrency, viewing regulation through the lens of their own organization rather than holistically. In May 2018, the CFTC issued guidance to clearinghouses and exchanges planning to list crypto-related derivatives products.[55] In February 2018, the SEC suspended trading in three companies, warning investors to "give heightened scrutiny to penny stock companies that have switched their focus" to take advantage of the popularity of "cryptocurrency and blockchain technology-related assets."[56] The Financial Crimes Enforcement Network ("FinCEN") also jumped into the fray, most recently issuing guidance in May 2019 that "consolidates current FinCEN regulations, and related administrative rulings and guidance issued since 2011" and applies them to cryptocurrencies that fall under the applicable business models.[57] Lastly, and overarching all of the above, the IRS applied their taxing authority to crypto transactions in an attempt to not leave any potential tax revenue on the table.[58]

While each organization should be applauded for proactively offering guidance, the killer of cryptocurrency innovation could be regulation.[59] In a panel discussion on enforcement activities within

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[54] Reddy, *supra* note 25, at 264 (citing Don Tapscott & Alex Tapscott, *Blockchain Revolution: How the Technology Behind Bitcoin and Other Cryptocurrencies is Changing the World* 56 (2018)).
[55] CFTC Staff Issues Advisory for Virtual Currency Products, CFTCLTR No. 7731-18 (May 21, 2018).
[56] S.E.C. News Release IR-2018-20 (Feb. 16, 2018).
[57] FinCEN Guidance FIN-2019-G001 (May 9, 2019).
[58] *See* R.R. 2014, *supra* note 13.
[59] *See* Aaron Cutler & Kevin Wysocki, *INSIGHTS: Cryptocurrency Has Washington's Attention, But Beware Overregulation*, BLOOMBERG LAW (July 24, 2019), https://biglawbusiness.com/insights-cryptocurrency-has-washingtons-attention-but-beware-overregulation; Julio Rivera, *Will Overregulation Stifle the Good of*

crypto-regulation, lawmakers stated they did not want to "hinder innovation or interfere unduly with blockchain or the tokens built on the nascent technology."[60] However, with each regulatory authority creating guidance and reporting standards, cryptocurrency might face a "death by a thousand cuts"[61] type of scenario where the costs of compliance with each agency's regulations make crypto investments much less profitable.

Congress, seemingly aware of this possibility, proposed the Crypto-Currency Act of 2020, the latest attempt after other legislation failed to pass into law.[62] The bill's stated purpose is to "clarify which Federal agencies regulate digital assets, to require those agencies to notify the public of any Federal licenses, certifications, or registrations required to create or trade in such assets, and for other purposes."[63] The bill proposes categorizing digital assets into three separate categories with distinct definitions: cryptocurrencies, cryptocommodities, and cryptosecurities.[64] Then, FinCEN, the CFTC, and the SEC would have the sole power to regulate the category that falls under their respective jurisdiction.[65] FinCEN would regulate cryptocurrencies.[66] The CFTC would regulate crypto-commodities.[67] The SEC would regulate crypto-securities.[68]

Cryptocurrencies?, REAL CLEAR MARKETS (Feb. 19, 2019), https://www.realclearmarkets.com/articles/2019/02/19/will_overregulation_stifle_the_good_of_cryptocurrencies_103629.html#!.

[60] Nikhilesh De, *US Regulators Say They Want to Avoid 'Hindering' Blockchain Innovation*, COINDESK (May 15, 2018), https://www.coindesk.com/us-regulators-say-want-avoid-hindering-blockchain-innovation [hereinafter De, *US Regulators*].

[61] Will Kenton, *Death by a Thousand Cuts*, INVESTOPEDIA (updated Jan. 9, 2020), www.investopedia.com/terms/d/death-1000-cuts.asp ("[A] failure that occurs as a result of many smaller problems. Death by a thousand cuts could refer to the termination of a proposed deal as a result of several small issues rather than one major cause.").

[62] Jason Brett, *Congress Considers Federal Crypto Regulators In New Cryptocurrency Act Of 2020*, FORBES (Dec. 19, 2019) https://www.forbes.com/sites/jasonbrett/2019/12/19/congress-considers-federal-crypto-regulators-in-new-cryptocurrency-act-of-2020/#55efdda45fcd.

[63] *Id.*

[64] *Id.*

[65] *Id.*

[66] *Id.*

[67] *Id.*

[68] Brett, *supra* note 62.

B. Canada

Under the Canada Revenue Agency (the "CRA"), taxation and regulation of cryptocurrency is relatively streamlined compared to the United States' regulations. Any receipt of a cryptocurrency by purchase, gift, or fork does not create a taxable event.[69] Generally, the valuation of the currency at the time of receipt forms the tax basis for capital gains calculations.[70] In the case of a hard fork, where a taxpayer receives a newly-minted token, the CRA is "quite clear" that the tax basis for the forked coin is zero.[71] However, once the currency is sold or disposed of in some manner, a taxable event occurs for the taxpayer.[72] A sale of cryptocurrencies can be taxed as (1) ordinary income if the transaction was conducted as part of a business activity; or (2) a capital gain if the transaction does not "constitute carrying on a business."[73] Notably, the CRA uses an inclusion rate of fifty percent, meaning only half of a capital gain (or loss) is actually subject to tax.[74]

C. South Korea

South Korea is taking a measured approach to address cryptocurrency taxation. After a tumultuous period of varying reports in early 2018,[75] the South Korean Ministry of Economy and Finance, which oversees the country's economic policy, has recognized that "individual investors' crypto trading profits cannot be taxed under the

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[69] *Guide: Bitcoin & Crypto Tax in Canada - 2020*, KOINLY BLOG, https://koinly.io/guides/crypto-tax-canada/ (last updated Dec. 22, 2019).
[70] *See id.*
[71] *Id.*
[72] *See* Canada Revenue Agency, *Guide for cryptocurrency users and tax professionals*, https://www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/compliance/digital-currency/cryptocurrency-guide.html (last updated June 27, 2019) [hereinafter CRA].
[73] *Id.*
[74] Canada Revenue Agency, *Inclusion rates for previous years*, https://www.canada.ca/en/revenue-agency/services/tax/individuals/topics/about-your-tax-return/tax-return/completing-a-tax-return/personal-income/line-127-capital-gains/you-calculate-your-capital-gain-loss/inclusion-rates-previous-years.html (last updated Jan. 21, 2020).
[75] *See* Choi Hoon-gil, *Justice Department "Closes Virtual Currency Exchange"*, NAVER (Jan. 1, 2018), https://m.news.naver.com/hotissue/read.nhn?sid1=101&cid=1074429&iid=2718120&oid=018&aid=0004009939.

current tax law."[76] Officials are therefore planning on introducing a new bill to allow taxation on gains made from crypto-trading.[77] While a revised tax bill has not been put forward at the time of this writing, the Ministry is currently "preparing a taxation plan for virtual assets by comprehensively reviewing the taxation of major countries, consistency with accounting standards, and trends in international discussions to prevent money laundering," according to one government official.[78]

D. Germany

Germany's Ministry of Finance's 2018 guidance on crypto-taxation "sets Germany apart from the U.S."[79] While the IRS treats cryptocurrency as property, the Ministry of Finance considers Bitcoin to be legal tender when used as a means of payment.[80] This means that a "sale" of crypto in a transaction to buy a coffee, for example, would not have any tax implications beyond a standard value-added tax ("VAT").[81] Germany's VAT tax is similar to a sales tax in the United States and is levied at all levels of supplying a good or service within Germany's jurisdiction.[82] As such, the tax would be collected by the merchant to be sent to the government's revenue department.[83] By offloading reporting onto the merchant instead of the individual crypto-investors, the administrative burden is lessened, as less entities must report the transaction and therefore regulatory agencies have less actors to monitor.[84] The document outlining the Ministry of Finance's outlook states "[v]irtual currencies . . . [will] become the equivalent to

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[76] Kevin Helms, *Government Confirms Crypto Profits Not Taxable in South Korea*, BITCOIN.COM (Jan. 2, 2020), https://news.bitcoin.com/government-confirms-crypto-profits-not-taxable-in-south-korea/ [hereinafter Helms, *South Korea*].
[77] *Id.*
[78] *Id.*
[79] Nikhilesh De, *Germany Won't Tax You for Buying Coffee With Bitcoin*, COINDESK (Feb. 28, 2018), https://www.coindesk.com/germany-considers-crypto-legal-equivalent-to-fiat-for-tax-purposes [hereinafter De, *Germany*].
[80] *Id.*
[81] *Id.*
[82] *VAT and Sales Tax Rates in Germany for 2020*, WORLD TAX RATES, http://world.tax-rates.org/germany/sales-tax (last visited Feb. 14, 2020).
[83] *Id.*
[84] *See id.*

legal means of payment, insofar as these so-called virtual currencies of those involved in the transaction as an alternative contractual and immediate means of payment have been accepted."[85] Additionally, mining operations, the process of adding more crypto to markets, are not considered taxable activities for VAT purposes.[86]

E. France

Similar to Germany, France is assessing the proper way to assign a VAT to crypto-transactions. In 2018, the French State Council (Conseil d'État) announced in a press release that profits from cryptocurrency sales were being recategorized as "movable property" so they could benefit from a lower tax rate under France's tax structure.[87] Furthermore, in September 2019, French Finance Minister Bruno Le Maire announced France will tax cryptocurrency gains when they're converted into "traditional" currency, but crypto-to-crypto transactions will remain tax-exempt.[88] He added "[w]e believe that the moment the gains are converted into traditional money is the right time to assess tax."[89] This step forward would ease the burden of tracking transactions, a challenge that can be tedious if not impossible, especially if taxpayers have to retroactively declare years of

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[85] De, *Germany*, *supra* note 79 (*citing* Umsatzsteuerliche Behandlung von Bitcoin und anderen sog. virtuellen Währungen; EuGH-Urteil vom 22. Oktober 2015, C-264/14, Hedqvist [VAT treatment of Bitcoin and other so-called virtual currencies; ECJ judgment of October 22, 2015, C-264/14, Hedqvist], Bundesministerium der Finanzen, [Fed. Ministry of Fin.] (2018) (Ger.)).

[86] Stefan Henkelmann & Lennart J. Dahmen, *Blockchain and Cryptocurrency Regulation 2020 | Germany*, GLOBAL LEGAL INSIGHTS (Oct. 23, 2019), https://www.globallegalinsights.com/practice-areas/blockchain-laws-and-regulations/germany#chaptercontent8.

[87] Conseil D'état Press Release, The Council of State specifies the methods of taxation of the profits drawn from the cession of "bitcoins" by individuals (Apr. 26, 2018) [hereinafter France].

[88] Rick Mitchell, *France Won't Tax Crypto-to-Crypto Trades, But Will Hit Gains Cashed Out*, BLOOMBERG TAX (Sep. 12, 2019, 7:40 AM), https://news.bloombergtax.com/daily-tax-report-international/france-wont-tax-crypto-to-crypto-trades-but-will-hit-gains-cashed-out.

[89] *Id.*

transactions once the regulation takes effect.[90] Furthermore, the simple tax structure will "facilitate both the declaration and the collection of taxes."[91] The main risk to such a simple strategy is governments would be "tempted to quickly implement sophisticated tax laws to maximize revenues before crypto holders get familiar with the notion of complying with regulations."[92] However, this "simple tax" would ease the burden of compliance while maximizing potential revenue to create a balance between supporting government coffers and allowing room for innovation and venture capital funding.[93]

F. Japan

Japan is considered a "crypto-positive nation" despite recently cracking down on cryptocurrency exchanges.[94] After the Japanese cryptocurrency exchange Coincheck was hacked in January 2018, losing the equivalent of $530 million USD to the hackers, Japan's Financial Services Agency ("FSA") issued "business improvement notices" to several cryptocurrency exchanges.[95] However, Japan recovered from these setbacks, becoming the first country to regulate cryptocurrency exchanges and to encourage technological innovation while ensuring consumer protection.[96] In October 2018, the FSA granted the Japan Virtual Currency Exchange Association ("JVCEA") the status of a self-regulatory organization ("SRO").[97] Similar to other institutions in the financial services industry, like the United States'

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[90] Tim_AXAI, *Cryptocurrency Taxation In France*, Altcoin Magazine (Sep. 22, 2019), https://medium.com/the-capital/cryptocurrency-taxation-in-france-de88fed243c4.

[91] *Id.*

[92] *Id.*

[93] *Id.* ("[The announcement] is good news for cryptocurrency investors as tracking and declaring every single transaction is tedious and sometimes near impossible if you have to retroactively declare years of transactions. Also, implementing a simple tax regime will facilitate both the declaration and the collection of taxes.").

[94] *See* Maria Ohle, *Japan's Finance Minister Considers a Change to Crypto Taxation*, CRYPTO CURRENCY NEWS (June 25, 2018), https://cryptocurrencynews.com/Japan-Cryptocurrency-Tax.

[95] *Id.*

[96] Taiga Uranaka, *Japan Grants Cryptocurrency Industry Self-Regulatory Status*, REUTERS (Oct. 24, 2018), https://www.reuters.com/article/us-japan-cryptocurrency-idUSKCN1MY10W.

[97] *Id.*

FINRA, an SRO status allows the JVCEA to police and sanction exchanges for violations.[98] According to a senior official within the FSA, the JVCEA was granted SRO status because cryptocurrencies are "a very fast moving industry. It's better for experts to make rules in a timely manner than bureaucrats do."[99]

However, due to Japan's tax structure and classification of cryptocurrencies, crypto-owners in higher tax brackets could be taxed on as much as fifty-five percent of their profits.[100] This number has led to organizations, such as the Association of New Economy (JANE), to request that the FSA reclassify cryptocurrencies under the same tax structure as stocks and foreign exchanges, which are capped at twenty percent.[101] In JANE's proposal, the association also proposed no tax assessments on crypto-to-crypto transactions, similar to France.[102] JANE maintained that such changes would avoid harming innovation and hindering the growth of the crypto sector.[103] Reinforcing JANE's plea for regulatory change, in June 2019 the JVCEA itself requested changes to the FSA's crypto tax laws.[104]

V. WHAT IS A HARD FORK?

A fork is "when a blockchain diverges into two potential paths forward either with regard to a network's transaction history or a new rule in deciding what makes a transaction valid."[105] In more simplistic terms, a fork occurs when the blockchain is updated.[106] However, due to blockchains' immutable characteristics, any update creates a new copy of the blockchain code rather than writing over the now outdated

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98 *Id.*
99 *Id.*
100 Talha Dar, *Japan Financial Regulator Requested to Reduce Crypto Tax by Economic Alliance*, BITCOIN NEWS (Feb. 17, 2019), https://bitcoinnews.com/japan-financial-regulator-requested-to-reduce-crypto-tax-by-economic-alliance/.
101 *Id.*
102 *Id.*
103 *Id.*
104 Dennis Wafula, *Japan Exchanges Seek Reforms for Crypto Taxation*, COINGEEK (July 30, 2019), https://coingeek.com/japan-exchanges-seek-reforms-for-crypto-taxation/.
105 Amy Castor, *A Short Guide to Bitcoin Forks*, COINDESK (Mar. 27, 2017), https://www.coindesk.com/short-guide-bitcoin-forks-explained.
106 *See id.*

chain.[107] This creates two separate branches that "fork" away from each other: the updated chain and the non-updated chain.[108] Each branch is then free to develop its own path after the fork, completely independent of the other branch, while maintaining the same virtual history prior to the fork.[109] Users can then choose to support the updated version or remain on the original blockchain.[110]

Typically, the entire community peacefully switches to the new fork which becomes the canonical blockchain.[111] The forked blockchain has the same history prior to the fork still encapsulated within the chain, but applies the updated code going forward.[112] This is called a "soft fork" because, while there is a split in directions of the blockchain, all users have migrated to the new branch and there is no contention between the two forks.[113] On the other hand, a "hard fork" occurs when the original chain and the updated version are both supported by the crypto-community and are considered valid by factions of the network.[114] This typically occurs as a result of users choosing to follow two different sets of programming rules on the blockchain.[115]

Forks generally occur when changes need to be made to the programming of a blockchain, but they can also describe a separate cryptocurrency splitting from the main blockchain.[116] Due to the difficulty in establishing a new blockchain-based currency, some crypto-developers base new virtual currencies on the blockchain of an

[107] Jeffery Atik & George Gerro, *Hard Forks on the Bitcoin Blockchain: Reversible Exit, Continuing Voice*, 1 STAN. J. BLOCKCHAIN L. & POL'Y 24, 29 (2018).
[108] *Id.*
[109] Danhui Xu, *Free Money, but Not Tax-Free: A Proposal for the Tax Treatment of Cryptocurrency Hard Forks*, 87 FORDHAM L. REV. 2693, 2698-99 (2019).
[110] *Id.*
[111] Atik, *supra* note 107, at 29.
[112] *Id.*
[113] Bratspies, *supra* note 37, at 29-30.
[114] *Id.*
[115] Castor, *supra* note 105.
[116] *Id.*

existing cryptocurrency that is already well-known, such as Bitcoin or Ethereum.[117] These variations are typically created with a hard fork.[118]

However, a cryptocurrency's community may not always agree on the future path of the currency, and this can lead to a "contentious hard fork."[119] A prime example is the hard fork of Bitcoin to Bitcoin Cash in August 2017.[120] This fork was the result of mounting tensions in the Bitcoin community over how to handle congestion on the blockchain.[121] The community was so split that accusations of self-dealing and bad faith arose and "erode[d] trust within the community."[122] Bitcoin and Bitcoin Cash, the two resulting cryptocurrencies, are both still popular and are traded on most cryptocurrency exchanges, such as Coinbase and Binance.[123] When a hard fork occurs, owners of the original cryptocurrency before the fork typically receive tokens[124] of the new crypto at a 1:1 ratio.[125] Thus for each Bitcoin investors owned before the 2017 hard fork, they also received one Bitcoin Cash once the network was upgraded.[126]

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[117] *See* Aaron Van Wirdum, With Forkgen, Anyone Can Now Create Their Own Bitcoin Fork (Even Us), BITCOIN MAG. (Dec. 21, 2017), https://bitcoinmagazine.com/articles/forkgen-anyone-can-now-create-their-own-bitcoin-fork-even-us.

[118] *See id.*

[119] Bratspies, *supra* note 37, at 29.

[120] *Id.* at 30.

[121] *Id.*

[122] *Id.* (*quoting* David Dinkins, *Opinion: Collapse of Bitcoin's "New York Agreement" Would Have Long Term Consequences*, COINTELEGRAPH (Sept. 16, 2017), https://cointelegraph.com/news/opinion-collapse-of-bitcoins-new-york-agreement-would-have-long-term-consequences).

[123] Aaron Hankin, *What You Need to Know About the Bitcoin Cash 'Hard Fork'*, MARKETWATCH (Nov. 15, 2018) https://www.marketwatch.com/story/what-you-need-to-know-about-the-bitcoin-cash-hard-fork-2018-11-13.

[124] Nick Lindsey, *Coins vs Tokens: What's the Difference?*, BLOCKLR, https://blocklr.com/guides/coins-vs-tokens-differences/. Note that tokens and coins are not necessarily the same. *Id.* Crypto coins operate on their own, independent blockchains. *Id.* On the other hand, a crypto token is built on top of an existing blockchain. *Id.* However, the cryptocurrency community is still developing and there are linguistical challenges as new terms and definitions are created to explain the technical concepts of cryptocurrency and blockchain. *Id.*

[125] Xu, *supra* note 109, at 2699.

[126] *Id.*

VI. ANALYSIS: MEANINGFUL STEPS FORWARD

A. The 2019 Guidance and its Implications

With the above developments in crypto-regulation since the IRS's last issued guidance in 2014, it was expected that the 2019 guidance would have well-informed, comprehensive insights into how the agency will work with taxpayers going forward. However, the IRS instead focused on a relatively niche topic: tax obligations caused by a hard fork.[127] The agency determined that a stakeholder has received gross income under §61 of the Internal Revenue Code ("IRC") once the stakeholder has received the new currency associated with the forked branch.[128] However, the IRS stated a taxpayer has not received the cryptocurrency "if the taxpayer is not able to exercise dominion and control over the cryptocurrency," citing a major holding of *Commissioner v. Glenshaw Glass Co.*[129] Under the *Glenshaw Glass* test, the taxpayer would not recognize any cryptocurrency as income until she acquires the ability to transfer, sell, exchange, or otherwise dispose of the cryptocurrency: at that time, the taxpayer is treated as receiving the cryptocurrency.[130]

Despite being seemingly straightforward, application of the *Glenshaw Glass* test is complicated by the distributed ledger characteristics of blockchain technology.[131] Since any third party can fork a blockchain in order to create their own digital currency, any taxpayer with the private keys would automatically have a reportable income event upon receipt of the forked currency.[132] Similarly, the same potential tax obligation is created for any cryptocurrency airdropped into a taxpayer's digital wallet.[133] "Airdropping" is a

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[127] *See* Press Release, *supra* note 4.
[128] R.R. 2019, s*upra* note 2.
[129] *Id.* at 2-3 (citing *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955) (holding that "all gains or undeniable accessions to wealth, clearly realized, over which a taxpayer has complete dominion, are included in gross income.")).
[130] *Id.* at 3.
[131] *Comm'r v. Glenshaw Glass Co.*, 348 U.S. at 431.
[132] Peter Van Valkenburgh, *IRS Cryptocurrency Guidance Answers Some Questions While Raising Messy New Ones*, COINCENTER (Oct. 9, 2019), https://coincenter.org/entry/irs-cryptocurrency-guidance-answers-some-questions-while-raising-messy-new-ones.
[133] *Id.*

means of distributing units of a cryptocurrency to the distributed ledger addresses of multiple taxpayers.[134] As long as a third party has access to a taxpayer's public key, then the third party could potentially create a tax obligation (provided the taxpayer can "exercise dominion and control" over the newly-received cryptocurrency, which may not always be the case).[135]

Hard forks of cryptocurrencies are much more tumultuous than anything *Glenshaw Glass* was meant to address because of their various applications and potential classifications. Peter Van Valkenburgh, Director of Research at Coin Center, had the following to say about the implications of the 2019 guidance:

> That means that anyone who forks a blockchain can, without warning or notice, create new tax obligations for every holder of coins on the old chain. The same goes for airdrops. Any time someone airdrops a coin to an address over which you have dominion and control, they will create a tax reporting obligation on your part. This is a very bad result.[136]

Van Valkenburgh argues that, even if a taxpayer was able to exercise dominion and control over a newly-received cryptocurrency, the guidance sets an unreasonable burden as taxpayers may not even be aware that the blockchain forked.[137] He goes on to compare the guidance to "owing income tax when someone buries a gold bar on your property and doesn't tell you about it. It's absurd and impossible to reasonably comply."[138]

Furthermore, the 2019 guidance fails to establish a *de minimis* exemption, where realized gains under a certain threshold could avoid

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[134] R.R. 2019, *supra* note 2, at 2. Note that the IRS's definition of IRS has come under scrutiny by some who argue that the IRS is conflating hard forks with airdrops. *See* Helms, *Experts*, *supra* note 7. More generally, an airdrop is a marketing strategy involving sending free coins or tokens to wallet addresses in order to promote awareness for a new virtual currency. Jake Frankenfield, *Cryptocurrency Airdrop*, INVESTOPEDIA (Nov. 12, 2019), https://www.investopedia.com/terms/a/airdrop-cryptocurrency.asp.

[135] Van Valkenburgh, *supra* note 132.

[136] *Id.*

[137] *Id.*

[138] *Id.*

a tax burden.[139] U.S. law makers have pushed for a *de minimis* threshold to no avail thus far.[140] However, such an exemption would provide tax relief for "low-level use cases" and "simplify the tax burdens of day-to-day crypto users who must report even marginal capital gains."[141]

As blockchain technology is implemented by a growing userbase, it follows that more players will create hard forks in order to adapt protocols of well-known blockchains to suit their needs.[142] In fact, cryptocurrencies are surprisingly easy to create because the technology is open-source, widely shared, and distributive.[143] Additionally, the number of cryptocurrencies in existence is already growing at a rapid pace.[144] As of March 2018, there were 1,658 cryptocurrencies[145] whereas, in January 2009, there was only one cryptocurrency: Bitcoin.[146] Considering the relative ease of creating a cryptocurrency, there is an increasing chance of more forks, more coins, and therefore more taxable events for crypto-owners on the original blockchain.[147]

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[139] *See* Nikhilesh De, *US Lawmakers Ask IRS to Clarify Crypto Tax Rules Around Airdrops, Forks in New Letter*, COINDESK (Dec. 20, 2019), https://www.coindesk.com/us-lawmakers-ask-irs-to-clarify-crypto-tax-rules-around-airdrops-forks-in-new-letter [hereinafter De, *Lawmakers*].

[140] Danny Nelson, *U.S. Lawmakers Try Again on Tax Relief for Small Crypto Payments*, COINDESK (Jan. 16, 2020), https://www.coindesk.com/us-lawmakers-try-again-on-tax-relief-for-small-crypto-payments.

[141] *Id.*

[142] *See* Emily Long, *How to Create Your Own Cryptocurrency*, LIFEHACKER (Apr. 23, 2018) ("Etherscan, which provides Ethereum analytics, has more than 71,000 token contracts in its archive. While the crypto market is volatile, experts believe that it will continue to mature as more people adopt the idea.") (internal citations omitted). While a hard fork is only one way to create a cryptocurrency (the other common method being to create your own blockchain and have your crypto operate on that chain), there are multiple "how-to" guides available. *Id.*

[143] Adam Drury, *How Many Cryptocurrencies Are There*, BLOCKLER, https://blocklr.com/guides/how-many-cryptocurrencies-are-there/ (last visited Feb. 14, 2020).

[144] Matthew Frankel, *How Many Cryptocurrencies Are There*, MOTLEY FOOL (Mar. 16, 2018), https://www.fool.com/investing/2018/03/16/how-many-cryptocurrencies-are-there.aspx.

[145] *Id.*

[146] Stephen Small, *Bitcoin: The Napster or Currency*, 37 HOUS. J. INT'L L. 581, 587 (2015).

[147] *See* Long, *supra* note 142.

Jameson Lopp, the CTO of Casa, a cryptocurrency startup, sent the following in a series of tweets regarding the IRS 2019 guidance:

> Today's IRS guidance is a hot mess.
> 1.What if you have keys but not software from which to spend the asset?
> 2. What if you never sell or transfer the asset and it drops 90% in value?
> 3. What's the value if the asset isn't even trading at the time of fork?
> 4. What if spending your fork coins poses privacy and security risks you want to avoid?
> 5. What if the fork coin has an artificially high value and no liquidity?
> 6. What if ain't nobody got time for that?[148]

With the possible exception of number six,[149] each of these questions bring up valid points under the current guidance. As Lopp points out, making the receipt of new cryptocurrency from a hard fork a taxable event is potentially disastrous.[150] If the forked coin has an artificially high value, or even no value at all, taxpayers could incur tax obligations without a realizable gain ever being realistic. And if there are issues with selling or exchanging the new coin (either due to cybersecurity concerns or lack of liquidity in the market), then taxpayers would have a tax obligation without feasibly being able to actually exercise dominion and control over the cryptocurrency.[151]

Congress also questioned the clarity of the IRS's most recent guidance.[152] Eight House Representatives, including members of the

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[148] Jameson Lopp (@lopp), TWITTER (Oct. 9, 2019, 9:56 AM), https://twitter.com/lopp/status/1181976686897848320; Jameson Lopp (@lopp), TWITTER (Oct. 9, 2019, 10:09 AM), https://twitter.com/lopp/status/1181980062318551040.
[149] *Id.*
[150] *Id.*
[151] Van Valkenburgh, *supra* note 132.
[152] *See* Letter from Tom Emmer, *et al.*, Congressmembers, to Charles P. Rettig, Commissioner of the IRS (Dec. 20, 2019), https://coincenter.org/files/2019-12/letter-to-irs-dec-20.pdf [hereinafter Emmer Letter].

Congressional Blockchain Caucus,[153] signed a 2019 letter asking for more clarification.[154] The letter suggests that the current guidance "creates potentially unwarranted tax liability and administrative burdens for users . . . and would create inequitable results."[155] The letter goes on to criticize the unrealistic fact patterns provided as examples and failure to "contemplate the vast varieties of products offered in the cryptocurrency market."[156] In addition to asking specific questions about the 2019 guidance, the letter states "it is imperative that the IRS publish clear information in further guidance" and suggests "increased work with the [cryptocurrency] industry in the future."[157]

The above criticisms demonstrate the gap between the IRS's current efforts to address concerns of crypto-owning taxpayers and the expectations of the crypto community. "[C]ryptocurrency users continue to lack any meaningful clarity about their tax obligations with respect to forks and airdrops."[158] Under the current interpretation of how cryptocurrencies should be reported, the receptor of a fork or airdrop could face taxation without any knowledge of such an event occurring.[159] Nonetheless, the IRS has been ramping up its efforts in taxing crypto transactions.[160] In July 2019, the tax agency sent letters to more than 10,000 taxpayers who might have improperly reported or failed to report cryptocurrency transactions.[161]

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153 The Congressional Blockchain Caucus is a formal group of lawmakers who advocate for blockchain technology and cryptocurrencies. De, *Lawmakers*, *supra* note 139. The Caucus's members, a bi-partisan group of Members of Congress and Staff, take a "'hands-off' regulatory approach with a belief that blockchain applications and technology will evolve on its own similar to how the internet matured." Jeremy Drzal, *What is the Congressional Blockchain Caucus?*, BLOCK512 (Sept. 11, 2017), https://block512.com/congressional-blockchain-caucus/.

154 Emmer Letter, *supra* note 152.

155 *Id.*

156 *Id.*

157 *Id.*

158 *Id.*

159 Alfonso Martinez, *US Congress Members Send Letter to IRS Commissioner Asking for Further Clarity on Crypto Tax Laws*, CRYPTO ECONOMY (Dec. 21, 2019), https://crypto-economy.com/us-congress-members-send-letter-to-irs-commissioner-asking-for-further-clarity-on-crypto-tax-laws/.

160 Helms, *Experts*, *supra* note 7.

161 I.R.S. News Release IR-2019-132 (July 26, 2019) [hereinafter IRS Letter].

To ease the administrative burden of tracking these transactions, the IRS should instead consider granting leniency on past transactions. By attempting to collect on ten or more years of transactions,[162] the agency would be burying themselves in forms as taxpayers attempt to report every transaction that they conducted since Bitcoin was first created. This is all exponentially worsened if the IRS considers crypto-to-crypto transactions to be a reportable event.[163] As an example, in the third quarter of 2019, the average *daily* number of transactions for Ethereum was 705,720.[164] Any expectation of tracking all crypto-to-crypto transactions and monitoring taxpayers' compliance is completely unrealistic.

B. Looking to the Past for Answers

The IRS should be analyzed under a clearer, consumer-focused standard rather than attempting to conform cryptocurrencies to the *Glenshaw Glass* test. Whether a hard fork should be taxed as gross income under § 61 of the IRC could be better analyzed under the framework of *Eisner v. Macomber*, a predecessor to the *Glenshaw Glass* test.[165] In *Eisner*, the Supreme Court found that a pro rata stock dividend was not taxable income because: (1) the shareholder received no cash; (2) the proportionate ownership among the shareholders was not altered; and (3) the shareholder did not realize income through the

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[162] Bitcoin was originally created in January 2019. Small, *supra* note 146, at 587. As of yet, the IRS has not discussed any consideration of leniency for past transactions and, it appears, they instead plan to collect on all past crypto-transactions. *See* IRS Letter, *supra* note 161.

[163] The IRS recently released a proposed draft of Form 1040 for the 2020 tax year. *Draft 1040 and 1040-SR*, I.R.S. (Oct. 23, 2020), https://www.irs.gov/pub/irs-dft/i1040gi--dft.pdf. Notably, the proposed draft asks returnees if they sold any cryptocurrency, exchanged cryptocurrency for goods or services, or exchanged cryptocurrency for property, including other crypto-assets. *Id.* Thus, it appears that the agency views crypto-to-crypto transactions as reportable events. However, the proposed draft also notes that "the transfer of virtual currency from one wallet or account you own or control to another that you own or control" is not a reportable event. *Id.*

[164] M. Szmigiera, *Average number of daily cryptocurrency transactions in 3rd quarter of 2019, by type*, STATISTA (Nov. 28, 2019), https://www.statista.com/statistics/730838/number-of-daily-cryptocurrency-transactions-by-type/.

[165] *See Eisner v. Macomber*, 252 U.S. 189 (1920) (holding that a pro rata stock dividend paid by a corporation is not taxable income).

sale of exchange of their stock.[166] Similar to a shareholder who receives a stock dividend but has not realized any gain, a crypto-holder can receive a token (by airdrop or by a forked chain) and hold it without ever realizing a gain or potentially even without knowing they received new tokens.[167]

Under the first prong of *Macomber*, a forked blockchain that leads to the issuance of a new crypto token does not create cash for investors.[168] In the case of a hard fork, an investor who owned the original coin would receive a newly created token after the fork is established, not cash.[169]

Under the second prong of *Macomber*, a forked token would not be considered taxable gross income because the proportionate ownership among all shareholders is not altered.[170] All investors who held a coin prior to a fork receive the newly created token at a ratio of 1:1 with their holdings prior to the fork.[171] While an argument may be made that there is an altered proportionate ownership if a virtual exchange chooses not to support a forked coin,[172] these issues are also present under the *Glenshaw Glass* test because the investor would not be able to exercise dominion and control over the forked coin until the exchange on which they are operating chooses to support the fork.[173] Thus, any slight discrepancies are rendered moot when comparing the two standards for purposes of deciding whether a taxable event has occurred.

Under the third and final prong of *Macomber*, a shareholder must realize income through a sale or other exchange of the

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[166] *Id.* at 207-15.
[167] Van Valkenburgh, *supra* note 132 ("You have keys that might be able to move potentially valuable new coins on that forked chain, but you may have no idea the fork even happened.").
[168] *See Eisner*, 252 U.S. at 214-15.
[169] Xu, *supra* note 109 at 2699.
[170] *See Eisner*, 252 U.S. at 202.
[171] Xu, *supra* note 109 at 2699.
[172] *See id*. at 2701 (explaining that some cryptocurrency exchanges may choose not to support a forked coin, leading to a change in the "proportionate ownership" of a coin if the coin's investors are spread out across multiple exchanges, and to delays that mean the taxpayers' "accession to wealth" is not necessarily clearly realized at the time of the hard fork).
[173] *Comm'r v. Glenshaw Glass Co.*, 348 U.S. at 431.

cryptocurrency.[174] While exchanging one cryptocurrency for another could be compared to exchanging one stock for another, there are some key differences that distinguish the two. In the traditional exchange of stock, there is still a moment during the transaction where the outgoing stock is converted to cash, which is then used to purchase the new stock in one's portfolio. However, an investor in cryptocurrencies does not need to convert to a fiat currency in order to exchange cryptocurrencies within their wallet.[175] Rather, it's possible to convert cryptocurrencies into one another without ever making a crypto-to-cash transaction, avoiding the realization of income until an investor chooses to "cash out."[176] Additionally, there is the tax policy consideration of administrative burden. If the IRS did consider each crypto-to-crypto transaction to be a taxable event, the added administrative toll that the agency would incur cannot be stressed enough. Every transaction would be an event reported by individual taxpayers, despite investors not realizing any cash gain.

Thus, under the *Macomber* framework, a taxpayer would not yet have a taxable event upon the mere issuance of a forked crypto.[177] Instead, a taxpayer would likely create a taxable event upon the conversion of her cryptocurrency to fiat currency. This avoids a whole range of issues, including the valuation of highly volatile cryptos[178] (and forked coins that have no historical valuation) and lessening the administrative burden on both the taxpayer and the IRS.

C. Looking Internationally

Lawmakers and agencies such as the IRS should look abroad to model regulatory structures in a way that protects citizens from potential dangers while allowing room for innovation to incorporate blockchain technology into business. Rather than providing disjointed regulation that addresses issues reactively rather than proactively, the

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174 *Macomber*, 252 U.S. at 207.

175 Coinbase Help Center, *Convert Cryptocurrency FAQ*, COINBASE ("Users can trade between two currencies directly. For example: exchanging Ethereum (ETH) with Bitcoin (BTC), or vice versa . . .. Fiat currency (ex: USD) is not needed to trade.").

176 *See id.*

177 *See Macomber*, 252 U.S. at 189.

178 *See* Sebastian Sinclair, *Volatility, Illiquidity Threaten BSV's Newfound Position*, COINDESK (Jan. 28, 2020), https://www.coindesk.com/volatility-illiquidity-continue-to-threaten-bsvs-newfound-position.

IRS should understand that there are many factors involved in cryptocurrency and a measured, flexible solution is the responsible approach. Much like South Korea, the IRS can review "international trends and the approaches of major countries to crypto taxation in an effort to amend the existing [American] tax law to include cryptocurrency," rather than attempting to define cryptocurrency by preexisting standards.[179] Regulators can adopt a restrained approach until the proper framework is in place, instead of issuing guidance that is criticized for not even understanding key terminology and distinctions.[180] Furthermore, by turning an eye to "trends in international discussions to prevent money laundering," lawmakers can coordinate globally in order to reduce financial crime rather than creating a system that may not fit with global standards.[181] This would also afford other agencies that have a stake in crypto-regulation, such as FinCEN, the opportunity to voice official opinions on proposed changes by the IRS.

By emulating Germany, U.S. lawmakers can incorporate a *de minimis* threshold to allow small transactions for real purchases, like a coffee, to escape the need for capital gains reporting. Similar to the threshold exemption for foreign currencies,[182] reporting capital gains for such small transactions would only serve to burden the IRS with monitoring more transactions than necessary, especially as use of cryptocurrencies as a form of payment becomes more prevalent.[183]

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[179] Helms, *South Korea*, *supra* note 76.

[180] Van Valkenburgh, *supra* note 132 ("Aside from offering bad policy on the question of hard forks, the [IRS 2019] guidance also doesn't describe these events correctly. It suggests that some hard forks come with airdrops and some do not. However, airdrops and hard forks are distinct and unrelated terms that the IRS seems to be conflating.").

[181] Helms, *South Korea*, *supra* note 76.

[182] *See* Ana Alexandre, *Crypto Tax Bill Introduced in the U.S. House of Representatives*, COIN TELEGRAPH (Aug. 7, 2019), https://cointelegraph.com/news/crypto-tax-bill-introduced-in-the-us-house-of-representatives.

[183] *See Crypto and Bitcoin Taxes in the US*, COINBASE, https://www.coinbase.com/bitcoin-taxes#gainsandlosses (last visited Feb. 2, 2020) (explaining that calculating gains and losses is difficult if a taxpayer has done any of the following: "(1) [b]ought or sold crypto on another exchange; (2) [s]ent or received crypto from [another] wallet; (3) [s]ent or received crypto from another exchange . . .; (4) [s]tored crypto on an external storage device; (5) [p]articipated in an ICO; [or] [p]reviously used a method other than first in, first out (FIFO) to determine your gains/losses on digital asset investments."); Omar Faridi, *American Tax Collection Agency Might Monitor Crypto Transactions More Closely*, CRYPTOGLOBE (July 15,

However, the IRS has not issued any guidance even discussing *de minimis* thresholds, which leads one to think that it has not been considered by the agency.[184] By creating *de minimis* thresholds, normal, everyday purchases made with cryptocurrency would no longer have unnecessary red tape. There's little to be gained by requiring capital gains to be reported every time an ordinary, taxpaying citizen uses cryptocurrency to purchase something as insignificant as a morning latte.

If the United States applied France's perspective[185] on crypto-to-crypto trading, administrative burdens and taxpayer confusion would be lessened even further. By establishing this French rule, where taxpayers only realize a gain or a loss when switching from crypto to fiat currency, taxpayers would easily understand what the IRS expects. Further, a better understanding of the IRS's expectations would decrease the amount of taxpayers who "failed to report income … or did not report their transactions properly."[186] Under the current IRS guidance, taxpayers are "liable for tax, penalties and interest," and in some cases are "subject to criminal prosecution" without any grace period, despite the lack of clarity provided by the IRS in the five years since the 2014 guidance was issued.[187] This guidance needs to be resolved because taxpayers who may be unaware that they have incurred a reporting obligation will be punitively fined for something as simple as a forked coin they were unaware they possessed.

Additionally, many of the deficits detected in the IRS's guidance thus far would be resolved if the United States emulated France's policy of taxable events only being created upon the sale of a digital currency. While taxpayers would still have to track their crypto-to-crypto transactions to accurately establish their tax basis, this move would ease reporting obligations and administrative burden, saving costs. If a taxable event is only created upon the conversion of a cryptocurrency to a fiat currency or in the payment for a good or service, even taxpayers who are relatively unfamiliar with the technicalities of blockchain technology would understand when they

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2019), https://www.cryptoglobe.com/latest/2019/07/american-tax-collection-agency-might-monitor-crypto-transactions-more-closely/.

[184] *See* R.R. 2014, *supra* note 13; R.R. 2019, *supra* note 2.

[185] *See* France, *supra* note 87.

[186] IRS Letter, *supra* note 161.

[187] *Id.*

have incurred a reporting obligation. This system would also make the need for any reporting obligations upon the hard fork of a cryptocurrency obsolete, immeasurably reducing the taxpayers' administrative burdens. Similar to France, in the case of a hard fork, the forked currency would have a tax basis of zero, as this is essentially the cost at which the taxpayer received the forked token. Taxpayers would then have the freedom to conduct transactions and choose when a taxable event occurs, rather than be subject to obligations they might not even know exist.

If the United States applied Canada's system[188] of taxing at an inclusion rate of less than 100 percent, innovation and investment could also be driven into cryptocurrencies as taxpayers would see this change as a potential tax incentive. By reducing the inclusion rate to fifty percent, for example, a $1,000 capital gain on the sale of a Bitcoin would only have a $500 reporting obligation. This system of receiving half of an investor's gains back tax-free would drive greater investments into this new asset class, fostering further innovation.

Furthermore, Japan's steps toward creating an SRO out of crypto exchanges[189] could be utilized under U.S. exchanges as well, similar to organizations such as FINRA. If U.S. virtual exchanges formed an SRO, reporting standards to the IRS could be streamlined as transactions between cryptocurrencies and fiat currencies or real-world services could be documented on the blockchain. While crypto investors not using exchanges would still need to report capital gains on their 1099s, the amount of administrative burden reduced by organizing capital gains made by those trading over established exchanges could be drastically beneficial. Additionally, an organization purely devoted to crypto-regulation would be best-suited to stay abreast of developments in the "fast moving industry."[190]

Based on current attempts by regulatory authorities to introduce piecemeal regulation, meaningful regulatory guidance must be introduced by legislative means. Agencies are confined within their respective agencies' purposes and statutory scope. Some Congressmembers are acutely aware that the IRS's most recent

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[188] CRA, *supra* note 72, at 13.
[189] Uranaka, *supra* note 96, at 17.
[190] *Id.*

guidance "leaves much to be desired"[191] and, thus, have taken initiative by introducing bills that are aimed at providing clearer tax laws on crypto and lessening tax burdens on business in order to foster industry growth within the United States.[192] As Representative Tom Emmer (R-MN), a co-chair on the Congressional Blockchain Caucus, stated, "[t]he potential economic opportunity that blockchain presents, not to mention how it could transform different industries and improve them and grow our economy as a whole over time, is enormous."[193] However, this potential can be squandered if overregulation prevents "the American people from their opportunity to see where cryptocurrency innovations could go."[194] In practice, the proposed bill may be the best approach thus far in attempting to bring comprehensive regulation to "the vast varieties of products offered in the cryptocurrency market."[195]

VII. CONCLUSION

"Whether cryptocurrency investments will impact the real economy positively or negatively is still unclear."[196] However, by adopting some of these best practices that are currently in place around the world, the United States can save itself from wasting resources on over-the-top regulatory oversight, become a leader in innovation in the crypto-community, and provide clearer guidance for taxpayers looking to cryptocurrencies as a new form of investment or payment. Furthermore, added clarity will naturally create tax revenues as taxpayers will have a better understanding of their reporting obligations under a comprehensive and clear tax

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[191] De, *Lawmakers*, *supra* note 139.

[192] *See* Max Boddy, *U.S. Lawmaker Reintroduces 'Safe Harbor' Crypto Tax Bill in Congress*, COIN TELEGRAPH (July 10, 2019), https://cointelegraph.com/news/us-lawmaker-reintroduces-safe-harbor-crypto-tax-bill-in-congress; Alexandre, *supra* note 182.

[193] Kimberly Underwood, *The Congressional Link to Blockchain*, AFCEA (Aug. 1, 2019), https://www.afcea.org/content/congressional-link-blockchain.

[194] Cutler & Wysocki, *supra* note 59.

[195] Emmer Letter, *supra* note 152.

[196] Xu, *supra* note 109, at 2717 (c*iting* Conor Sen, *Cryptocurrencies Are Starting to Affect the Real Economy: Be Afraid*, BLOOMBERG (Dec. 18, 2017), http://www. bloomberg.com/opinion/articles/2017-1218/cryptocurrencies -are -starting-to -affect-the -real-economy).

infrastructure. More risk-averse investors would become more open to investing in digital currencies knowing that there is a regulatory framework in place. The IRS's current system of providing hit-or-miss guidance via an FAQ format does not and cannot fulfill those expectations, as it only grants guidance in one-off situations rather than providing comprehensive guidance. Instead, clear standards set by Congressional lawmakers, and with the input of experts in crypto, should be looked to for guidance. By adopting simple, straightforward regulation that the average investor can understand, a tax infrastructure can be put in place that creates flexibility, clarity, and lays the groundwork for more comprehensive regulation once the wide array of potential applications of such a disruptive technology is better understood.